



Missouri Division of Finance

UPDATE

A Report of Missouri State Chartered Financial Institutions

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INTERNET FRAUD

(Commissioner of Finance Earl L. Manning recently offered his thoughts on Internet fraud in a news release)

Persons making investments in Internet banks should exercise great caution warns Missouri's Commissioner of Finance, Earl L. Manning. "The Internet is a fantastic tool for legitimate businesspeople," said Manning. "It's an inexpensive, lightning fast way to reach unlimited markets of both customers and providers. There are no geographic restrictions." However, there is a downside. "All of these wonderful features," said Manning, "also make the Internet an attractive forum for swindlers and money launderers. Some state and federal regulators have already begun to identify and crack down on illegitimate users, but they are numerous and hard to find."

These organizations are often located abroad where they are much harder to reach effectively. "One identifying characteristic of these operators is that they usually promise high rates of return and complete confidentiality,"

Manning said. "Some of these are connected to anti-government groups, and persuade their customers to remain silent about their so-called investments, even past the time when their money has disappeared."

According to Manning, numerous legitimate banks, both state and nationally chartered, advertise their products and services, establish and maintain relationships and open new business accounts on the Internet websites. "We, of course, encourage them to continue the practice," said Manning. "However, Missourians are cautioned to research any financial institution before sending money or engaging in business." Engaging in business includes giving out any account numbers or social security numbers. "The location of the institution itself may be a tip-off," said Manning. "If they are located outside the United States, extreme caution should be used. The absence of FDIC insurance is also something to be concerned about. Finally, to use the old expression, 'if it sounds too

good to be true, it almost certainly is."

GENERAL USURY

Section 408.030 provides that the Director of Finance shall declare the quarterly market rate of interest each quarter, post it in accordance with Section 361.110 and publish it in appropriate publications. Said quarterly market rate for the period January 1, 1998 through March 31, 1998 shall be 9.2%; as an alternative, 10% may be used.

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NIGERIAN FRAUD

UPDATE has previously reported on the fraudulent solicitations sent to Missouri bankers ostensibly by current and former Nigerian officials (UPDATE, January 1997). Bankers who received them noted the misspellings and crudeness which made them apparently clumsy frauds and forwarded them to this office so a warning could be made to others. We have now received information that the frauds are more or less sophisticated versions of the "pigeon drop" which should be given no credence at all.

The letters claim to be on behalf of civil servants in Nigeria. A number of ploys are used, but the most common involves a description of some difficulties in releasing funds tied up by Nigeria's former military regime. The targeted banker (or other businessman) is asked to allow the use of his accounts to free up the millions of dollars in exchange for which there will be payment of a 30% commission. As the scam unfolds, certain fees and lugs must be paid in advance which is, of course, the real objective of the enterprise. Various tricks are used to separate the businessman from his money and no deal is ever completed. One businessman in St. Louis was fleeced of tens of thousands of dollars, all in easy installments. The victim can expect no assistance

from the Nigerian government; the central bank of that country referred to such victims as "villains" driven by greed.

The Missouri Attorney General's office has received literally hundreds of inquiries about these mailings. There is no way to estimate how many mailings have been made, but it must number into the thousands. The frauds are thorough: we are aware of a two-employee cabinet shop in Folk, Missouri which received a couple of solicitations. There is even good reason to believe that the perpetrators have resorted to counterfeiting postage stamps to keep costs down. The scam first came to light in the 1980's but this year has seen a massive proliferation of the letters.

The best approach after receiving a Nigerian offering of this sort: THROW IT AWAY.

The best advice to give a customer who has received such an offering: DITTO.

For further information, contact: U.S. Secret Service, Financial Crimes Division, 1800 G Street, NW, Room 942, Washington, D.C. 20223. Phone (202) 435-5850. Fax: (202) 435-5031.

INTERNAL CONTROL RISKS

Sound audit programs and internal controls are similar to buying insurance. The bank is protecting itself from the very real hazard of internal fraud. Part of the bank examination function is to identify where lapses in coverage exist. What are the most common internal control exceptions identified by bank examiners? To answer that, we randomly sampled 33 State examination reports completed in 1997. The following are the top five exceptions:

| | |
|-----|--|
| 30% | General ledger and subsidiary records lack adequate description of transactions and are not promptly posted. |
| 24% | Inadequate vacation policy; employees not separated from normal duties at least two consecutive weeks. |
| 21% | No internal auditor. |
| 15% | Weak procedures for wire transfers. |
| 15% | Lack of separate teller cash drawers for which they are solely responsible. |

Is your bank unnecessarily exposed to internal fraud from these frequently overlooked areas?

Y2K: CENTURY DATE CHANGE COMPLIANCE

Monday, January 3, 2000 may not be just another day at the office. The first business day of the third millennium has the potential to be a nightmare if you do not take action now.

The "Year 2000" problem has been widely reported and is variously known as "Y2K", "Century Date Change", "CDC", "Millennium Bug" and others. (The editors of UPDATE respectfully suggest this is actually a year 1999 problem: anticipate or suffer the consequences!) It is a worldwide problem that software engineers and regulators are working to head off.

The problem: most business applications use only two digits to specify years and will recognize the "00" in the year 2000 as the year "1900". Any software application that is date sensitive may be affected, e.g., items that have an expiration date of 2010 may be reported as having expired in 1910. A certificate of deposit with interest due from 1999 to 2000 may try to pay interest for a 99 year period. Delinquent loans may suddenly appear current.

Hardware can also be affected. Integrated circuits in PCs, telephones, fax machines, check sorters, ATMs, security systems, environmental controls, elevators, etc., may be "non-Y2K compliant". A simple test for your PC:

1. Disconnect from any network and exit any software.
2. Change the date to 12-31-99 and time to 23:59.
3. Turn the PC off then back on.
4. Wait a minute and check the date. If the date is Saturday, January 1, 2000, your PC is "Y2K compliant". If any other date is shown, you will have to upgrade prior to the century change.

The FFIEC has issued a statement on Y2K which requests each financial institution develop a plan to address Y2K. The plan should:

- Develop a risk assessment that identifies systems and applications that must be modified.
- Identify what must be modified.
- Evaluate alternatives (which applications should be redeveloped, replaced or modified).
- Estimate costs for modifications.
- Review, approve, and establish milestones to ensure timely completion of plan.
- Ensure new systems are 2000 compliant.

All steps should be completed by December 31, 1998 to allow one full year for testing.

Federal bank regulators have created an Internet site with information banks can use in dealing with the "Year 2000" problem — the possibility that computers will mistake the year 2000 for the year 1900. The Federal Financial Institutions Examination Counsel (FFIEC) has set up a web site at **www.ffiec.gov/y2k** that includes relevant government documents, speeches and other information on the year 2000 issue. Instructions for ordering a 10-minute video prepared by the Federal Reserve also are available.

(A final editorial admonition: Bankers might be well advised to prompt their computer-reliant customers on the need to anticipate any Y2K problems.)

CSBS OFFERS SCHOOLS TO BANKERS

The Conference of State Bank Supervisors (CSBS) is widely known as the professional association of the state banking departments and state-chartered banks throughout the nation. For many years, CSBS has been a main source of examiner training, offering various schools ranging from bank operations to executive level programs. Now these schools are being made available to commercial bankers and other financial services industry personnel. CSBS classes may be ideal to supplement existing training programs for all levels of bank

employees. They provide very constructive hands-on instruction on a variety of crucial banking issues.

Most classes are of one week duration and are held at the Victor J. Riley, Jr. Training and Development Center in Dallas, (although conference-style executive classes are usually held elsewhere). Lodging in Dallas is available at the neighboring Embassy Suites Hotel or the Clarion Suites Hotel. The Riley Center provides state-of-the-art computer training technology which has proven to

dramatically increase comprehension and retention of information. Classes are designed and instructed by senior supervisory personnel from the premier banking departments in the country.

Listed below are some of the classes offered by CSBS for 1998, along with a brief description. If you have any questions about the classes, contact Kerri Qualls at (800) 460-9227 ext. 118 or (214) 357-6690 ext. 118.

| CLASS | 1998 START DATE | PRICE* | DESCRIPTION |
|--------------------------------------|-----------------------|--------|--|
| Bank Operations School | 5/4 | \$695 | Strengthens student's understanding of the operational/accounting functions of a commercial bank. |
| Credit Evaluation School | 3/2 | \$695 | Teaches how to evaluate credit risk and its effect on the bank. |
| Bank Financial Analysis | 3/23 | \$695 | Explanation of the principles of bank financial analysis, using the Uniform Bank Performance Report. |
| Fundamentals of Fiduciary Activities | 9/14 | \$695 | Provides a framework for understanding primary trust concepts |
| Compliance School | 2/1 | \$695 | Intensive consumer law program. |
| School of Hard Knocks | 10/27 | \$695 | Examines what happened in banking in the 80s and 90s |
| Risk Management | 3/16 | \$495 | Addresses issues of risk in the banking industry. |

* All prices include tuition, course materials and breaks.

BANKRUPTCY: CEASE COLLECTION EFFORTS

When a borrower or a guarantor files bankruptcy, all collection efforts must stop immediately until okayed by the bankruptcy court. This is because an "automatic stay", which goes into effect when the bankruptcy is filed, prohibits suits, foreclosures and repossessions. It also prohibits the lender from taking a new security interest, or even asking the person in bankruptcy to start making payments or to renew the loan. One bankruptcy judge noted that anything more aggressive than a nod of the head and a civil "hello" might be a violation of law.

In a Chapter 7 or Chapter 11 proceeding, the automatic stay applies only to the party in

bankruptcy. For example, if the borrower is in bankruptcy but the guarantor is not, the lender may pursue its rights against the guarantor. But, in a Chapter 13 proceeding (wage earner plan), the automatic stay applies to EVERYONE who is obligated on the loan even though that person has not filed bankruptcy.

It is very important not to violate the automatic stay. If a lender pursues a person in bankruptcy, the lender can be held liable for both actual and punitive damages. In a recent bankruptcy case, a lender was penalized \$40,000 for repossessing and selling a car of a person who had filed a Chapter 13 bankruptcy.

BANKS' INSURANCE POWERS

Many bankers are interested in selling full lines of insurance, not just that commonly known as "credit related". This is understandable since insurance sales are financial services closely related to banking and they provide a profit center which does not pose any risk to the safety and solvency of the bank. However, the day has not yet come when banks are completely free to engage in the business of selling all kinds of insurance.

There are, on the other hand, many banks which are, due to various statutes and regulations, eligible to sell both credit related and noncredit related insurance. They are as follows:

A TRUST COMPANY (not a bank with trust powers) wherever located may serve as agent for all lawful purposes which would, of course, include activities as agent for insurance companies (see Section 362.105.3(7)). A number of banks have converted to trust charters under streamlined procedures established for this purpose.

A BANK IN A PLACE WITH A POPULATION OF 5,000 OR LESS may sell all types of insurance due to a Division of Finance "wild card" regulation. The regulation gave equal powers to Missouri's state chartered banks as those enjoyed by their nationally chartered counterparts (see 4 CSR 140-2.051). NOTE: a bank with a branch in a place meeting the population requirements may offer full insurance services at that branch.

A BANK IN ANY OTHER PLACE may provide full insurance services by leasing part of its lobby space to an insurance agency. Rules for the terms of the lease are found in 4 CSR 140-2.051. One very important provision is that, if the bank's "insiders" own the agency, the lease must provide for a rent equal to at least 20% of the commissions generated.